

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA

In re

Case No. 02-33648-DHW

Chapter 13

JOHN E. CLAY,

Debtor.

MEMORANDUM OPINION

John E. Clay filed a chapter 13 petition for relief on November 14, 2002. Luretta Washington, one of Clay's creditors, filed an objection to confirmation of his proposed plan. Ms. Washington contends that the plan cannot be confirmed for two reasons. First, Washington maintains that under Clay's plan creditors will not receive as much as they would were his estate liquidated under chapter 7. Further, Washington asserts that Clay is not applying all of his disposable income to payments under the plan.

An evidentiary hearing on confirmation was held March 31, 2003, at which the Washington objection was considered. At the hearing Clay was represented by co-counsel George W. Thomas and John A. Howard, Jr. Washington was represented by J. Myron Smith.

Jurisdiction

The court's jurisdiction in this matter is derived from 28 U.S.C. § 1334 and the United States District Court for the Middle District of Alabama's general order of reference. Further, because plan confirmation

disputes are core proceedings under 28 U.S.C. § 157, this court has jurisdiction to enter a final order and judgment in the proceeding at bar.

Findings of Fact

Clay's chapter 13 plan provides that he will pay \$694 each month to the chapter 13 trustee for 36 months. His only two secured creditors, Alabama National Guard Credit Union and First Nationwide Mortgage, will be paid directly rather than through the trustee. Therefore, all the payments made to the trustee, less Clay's attorney's fees and the trustee's fees and expenses, will be paid to unsecured creditors.

Clay owes only two unsecured debts totaling \$135,200. One in the amount of \$1,200 is owed to A. Rene Wright; the other in the amount of \$134,000 is owed to Washington. Upon completion of the proposed plan, these unsecured creditors will have been paid approximately \$22,434 or 17% of their claims.¹

Clay moved into his current residence at 2311 Ada Lane, Prattville, Alabama in May 2002. He owns this property jointly with his wife. The house, which has approximately 6,000 square feet, was built by Clay on four acres of land that he inherited.² The debtor has insured the home for

¹ The amount paid to unsecured creditors under the plan is calculated as follows: \$694 times 36 months equals \$24,984, which represents the gross amount to be paid to the trustee. Clay's attorney's fees are \$1,300, and the trustee's compensation and expense allowance is approximately \$1,250. Deducting the fees and expenses from the gross payments results in a net amount available to the unsecured creditors of \$22,434.

² About one-half the square footage of the house comprises an unfinished basement.

\$277,900, but he testified that the property is worth only \$240,000. Washington contends the home is worth \$275,000. The home is located about 12 miles outside the city limits of Prattville and is not situated within a subdivision. Clay contends that the location of the home diminishes its value.

The Ada Lane property is encumbered by a mortgage in favor of First Nationwide Mortgage. The principal balance of the note secured by this mortgage is \$235,000.

Two months prior to filing bankruptcy, Clay and his wife transferred their joint interest in a house and lot located at 318 Winderton Drive, Montgomery, Alabama, to their three daughters.³ At the time of the transfer the Winderton Drive property was unencumbered.

In year 2000 Montgomery County set the value of the Winderton Drive property at \$62,000 for ad valorem tax purposes.⁴ In October 2001 Clay insured the Winderton property for \$65,000.⁵ These two pieces of evidence are all that the court has in determining the value of this property. The court finds that the property is worth \$65,000. This finding is based principally on the fact that the tax appraisal is now three years old. The higher and more recent figure, represented by the insurance coverage

³ The exact date of the transfer or the consideration, if any, given by the transferees was not made part of the evidence, but the court infers from the evidence that the transfer is avoidable by a trustee in bankruptcy under 11 U.S.C. § 548. The debtor's statement of financial affairs reflects that the debtor transferred his one-half interest in the property as a gift on September 22, 2002.

⁴ See Debtor's Exhibit B.

⁵ See Creditor's Exhibit 1.

valuation, better accounts for general appreciation of the value of real estate occurring over the last few years.

Clay's bankruptcy schedules reflect that he has monthly disposable income of \$694.⁶ Clay proposes to pay this amount to the trustee each month. Washington challenges certain of Clay's claimed expenses, however, as being unreasonable.

Clay contributes \$668 each month to his own retirement fund. Half of the contribution is mandatorily withheld by his employer, but the other half of the contribution is made voluntarily by Clay.

Clay claims that his auto insurance premium is \$400 per month. A part of the premium purchases insurance on the vehicles of his adult daughters. The evidence did not establish what part of the premium was for coverage of vehicles owned by Clay and his wife and what part of the premium was for coverage of his daughters' automobiles.

Clay claims a monthly expense of \$350 for support of his adult daughters, none of whom live in his household. Two of the daughters, however, attend school. One attends a technical college and the other a university. Some, if not all, of the daughters have child care expenses for their own children.

Clay pays \$144 a month for health insurance and \$146 a month for life insurance.

Clay claims an expense of \$150 for laundry and dry cleaning. Further, he claims that he expends \$190 a month for clothing. Clay is a

⁶ See Schedule J.

professional educator and a part-time minister. Both of these professions require Clay to dress in professional attire and increase his laundry and dry cleaning costs. Clay's wife is also professionally employed as a revenue examiner for the State of Alabama. The clothing and laundry expenses include costs for both Clay and his wife.

Clay claims home maintenance and repair costs averaging \$245 per month. His home is relatively new, having been completed in May 2002, and requires little in the way of maintenance and repairs.

Finally, Clay makes a \$430 per month charitable contribution to his church. This monthly contribution amounts to approximately 6% of his gross monthly income.

Conclusions of Law The Best Interest Test

The court must confirm the plan if the requirements of 11 U.S.C. § 1325 are satisfied. Among those requirements is that the debtor must pay unsecured creditors at least as much as they would receive were the debtor's estate liquidated in chapter 7. The statute codifying the so-called "best interest" test provides:

- (a)the court shall confirm a plan if—
 - (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date.

11 U.S.C. § 1325(a)(4).

In the instant case, the objecting creditor contends that the two real properties discussed *supra* would yield more to unsecured creditors in a chapter 7 case than the debtor is proposing to pay to them under the chapter 13 plan. Hence, the court's task is to undertake a liquidation analysis of these properties to determine how much, if any, would be distributed to unsecured creditors from the sale of these properties in a hypothetical chapter 7 case.

Even assuming that the home on Ada Lane has a value of \$275,000 as Washington contends, the administration of this property in chapter 7 would produce nothing for the unsecured creditors. The liquidation analysis of the Ada Lane property is as follows:

Assume a fair market value of \$275,000. The principal balance of the note secured by a mortgage on this property is \$235,000 resulting in \$40,000 equity. The trustee would be required to pay realtor's commissions of approximately \$16,500 (6% of the gross sales price of \$275,000) leaving a net equity of \$23,500.⁷ One-half of that would be paid to Clay's wife for her interest in the property leaving a balance of \$11,750 in Clay's estate. The debtor would be entitled to a \$5,000 homestead exemption under Alabama law,⁸ leaving a balance of \$6,750.

⁷ The liquidation analysis must take into account the administrative costs that would likely be incurred by a trustee in a chapter 7 case. *In re Wilhelm*, 29 B.R. 912 (Bankr. D. N.J. 1983); *In re Dixon*, 140 B.R. 945 (Bankr. W.D. N.Y. 1992); cf. *In re Barth*, 83 B.R. 204 (Bankr. D. Conn. 1988);

⁸ *Ala. Code* § 6-10-2 (1975). The debtor has to date not claimed the homestead exemption available. This omission, however, may be corrected by a simple amendment if timely accomplished and prior to detrimental reliance being placed on the omission by another party.

However, the trustee's fee for administering this property would total \$17,000. See 11 U.S.C. § 326(a). Therefore, in a hypothetical chapter 7 case the trustee would abandon this realty.

Conversely, the property on Winderton Drive would be administered by the trustee in a hypothetical chapter 7 case. Using the avoidance powers of 11 U.S.C. § 548, the trustee would set aside the transfer of Clay's one-half interest in the property to Clay's daughters. Then, pursuant to 11 U.S.C. § 363(h), the trustee would sell the property for \$65,000. From that sum trustee would deduct \$3,900 in realtor's fees, assuming a 6% commission, leaving a net equity of \$61,100. One-half of that would be paid to Clay's wife for her interest in the property leaving a balance of \$30,550 in Clay's estate. Deducting \$6,500 in trustee's fees pursuant to 11 U.S.C. § 326 would leave a remaining balance of \$24,050. Further, the trustee would incur litigation expense for the adversary proceedings to avoid the transfer to Clay's daughters and then to sell the property under 11 U.S.C. § 363(h). Allowing \$1,000 for such litigation expenses would leave the Clay estate with \$23,050. Finally, Clay testified that repairs costing about \$4,000 would be necessary in order to market the Winderton property. Trustee would be required to pay these costs as well, which would leave the estate with approximately \$19,050 that could be disbursed to unsecured creditors.

Under the plan, unsecured creditors will receive \$22,400 over a three-year period. Hence, even when one considers the time value of money, the debtor's plan meets the best interest of creditors test. In short, unsecured creditors will receive, as of the effective date of the plan, as

much or more than they would receive were Clay's estate liquidated in a case under chapter 7.

The Disposable Income Test

In chapter 13 plans where unsecured creditors are paid less than in full, the debtor, upon objection by the trustee or a creditor, must devote for three years all disposable income for payment under the plan. The Bankruptcy Code provides:

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan— . . .

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

11 U.S.C. § 1325(b)(1)(B).

Further, the term "disposable income" is defined by the statute. The statute provides:

(b)(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—

(A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)) in an amount not to

exceed 15 percent of the gross income of the debtor for the year in which the contributions are made.

11 U.S.C. § 1325(b)(2)(A).

Washington has challenged certain of the debtor's claimed expenses as being unreasonably excessive, thus consuming otherwise disposable income. In determining a debtor's disposable income a court "is not expected to, and should not, mandate drastic changes in the debtor's lifestyle to fit some preconceived norm for chapter 13 debtors. The debtor's expenses should be scrutinized only for luxuries that are not enjoyed by an average American family." 8 Lawrence P. King, *Collier on Bankruptcy* ¶ 1325.08[4][b][ii], at 1325-53, 54 (15th ed. rev. 2001) (citing *In re Tinneberg*, 59 B.R. 634 (Bankr. E.D. N.Y. 1986); *In re Hedges*, 68 B.R. 18 (Bankr. E.D. Va. 1986)).

Each of the challenged expenses are addressed by the court as follows:

1) Retirement contributions:

In addition to the mandatory retirement plan offered by his employer, Clay contributes \$334 per month voluntarily to a supplemental retirement plan. The court concludes that this contribution is not reasonably necessary for the maintenance and support of the debtor and his dependents and must be included in the debtor's disposable income. *Anes v. Dehart (In re Anes)*, 195 F.3d 177, 180-81 (3rd Cir. 1999); *In re Cornelius*, 195 B.R. 831, 835 (Bankr. N.D. N.Y. 1995); *In re Cavanaugh*, 175 B.R. 369, 373 (Bankr. D. Idaho 1994); *In re Fountain*, 142 B.R.135, 137 (Bankr. E.D. Va. 1992); *In re Festner*, 54 B.R. 532, 533 (Bankr. E.D. N.C. 1985); *In re*

Lindsey, 122 B.R. 157, 158 (Bankr. M.D. Fla. 1991) (investment property).

2) Car insurance premiums and 3) Contributions to dependents outside the household:

The debtor pays \$400 each month in automobile insurance premiums. At least some of that amount provides coverage on vehicles of his adult daughters who do not live in Clay's household. Further, the debtor pays \$350 per month to these same children for their general support. Without more, however, the court cannot find that these expenses are unreasonable. Although Clay is assisting adult children who live outside his household, these children appear, nevertheless, to be dependents of the debtor as that term is used in 11 U.S.C. § 1325(b)(2)(A). The term dependent should be broadly interpreted to include any person who is reasonably dependent upon the debtor, to whatever degree, for support regardless of whether that person meets the definition of dependent under federal tax law. *In re Tracey*, 66 B.R. 63 (Bankr. D. Md. 1986). Here, two of the debtor's children are still in school. In order to continue with their education, assistance from the debtor in the form of automobile insurance and monetary assistance (which amounts to slightly over \$100 each month per child) is reasonable and need not be considered in Clay's disposable income.

4) Health insurance and 5) Life insurance:

Clay pays \$144 a month for health insurance and \$146 a month for life insurance. In scrutinizing the debtor's expenses the court should look to eliminate those for luxury not enjoyed by an average family. *Tinneberg*, 59 B.R. at 635. A monthly expense of less than \$300 for health and life

insurance for a 56-year-old man is not patently unreasonable and may be excluded from Clay's disposable income. To meet the disposable income test the debtor need not lower expenses to the poverty level. *In re Sitarz*, 150 B.R. 710, 718 (Bankr. D. Minn. 1993).

6) Laundry and dry cleaning and 7) clothing:

As with Washington's challenge to the debtor's health and life insurance expense claims, the court cannot, without more, conclude that these expenses are unreasonable. Both the debtor and his wife are professional people and accordingly, must dress in professional attire. Clay claims that he and his wife pay \$190 per month for clothing. This amounts to about \$1,140 per year for each of them and is not obviously extravagant. Hence, the expenses claimed by Clay for cleaning and laundry and for clothing are not unreasonable and may be excluded from his disposable income.

7) Home maintenance expense:

Washington contends that Clay's claimed \$245 per month expense for home maintenance and repairs is unreasonable. It is true that the debtor's house is less than one year old. As a result, Clay can hope to have fewer maintenance problems than does one owning an older parcel of property. But it does not necessarily follow that Clay will not expend that amount each year maintaining his property. In reaching this result the court is mindful that the immensity of the lot and the house alone makes maintenance and repairs more costly. Further, home repairs and maintenance expenses are not limited strictly to the upkeep of the realty, but may also include maintenance and repair of household appliances.

Therefore, the debtor's expense claim for home maintenance and repair may be included as a reasonable expense in his disposable income calculation.

8) Charitable contribution:

Finally, Washington challenges Clay's claimed monthly expense of \$430 to his church as unreasonable. The statute, 11 U.S.C. § 1325(b)(2)(A), expressly allows inclusion in the disposable income calculation charitable contributions of up to 15% of the debtor's gross income. Clay's claimed expense of \$430 per month amounts to only 6% of his gross income and therefore is properly allowable as a reasonable expense in the disposable income calculation.

Conclusion

For the foregoing reasons, Loretta Washington's objection to confirmation of John E. Clay's chapter 13 plan is overruled to the extent that she contends that the plan fails the best interest of creditors test. The objection, however, is sustained to the extent that the debtor has included voluntary contributions to his retirement system as an expense reducing his disposable income.

A separate order consistent with this opinion will enter denying confirmation and conditionally dismissing the case unless the debtor files an amended plan consonant with this holding.

Done this the 2nd day of May, 2003.

/s/ Dwight H. Williams, Jr.
United States Bankruptcy Judge

c: Debtor

George W. Thomas, Attorney for Debtor

J. Myron Smith, Attorney for Creditor

Curtis C. Reding, Trustee